22601

MEMORANDUM FOR: [redacted]
NIO/USSR/EE

This is the package of materials you requested for your briefing. The unclassified research papers and the outline were provided by [redacted] the remainder is from OER/U/TD.

[redacted]
Office of Economic Research

Attachment

Date 11 October 1978

FORM 5-75 101 USE PREVIOUS EDITIONS

[redacted]

SECRET [redacted]

USSR: Balance of Payments

The USSR currently enjoys a favorable balance of payments position; hard currency stringencies should not be counted as a factor behind the downturn in Soviet orders from the West. We currently estimate that the USSR will incur a deficit of roughly $4 billion in its hard currency trade this year, up from the $3.2 billion deficit registered in 1977 but well below the record deficits of 1975-1976. Moscow should be able to keep its current account deficit to under $1 billion for the second year running and is expected to enjoy a sizeable albeit diminished surplus in its capital account. [redacted]

Several factors support our estimate of a favorable short-term balance of payments position.

- The USSR has increased its assets in Western banks; at the end of March they stood at a record $4.3 billion. ([redacted]
- The bullish gold market has allowed the USSR to sell record amounts of gold this year and we anticipate that sales in 1978 will exceed $2 billion. ([redacted]
- Prospects for a record grain harvest indicate that Soviet demand for Western grain will be lower than last year. ([redacted]

23 ...PORT CL BY [redacted]

SECRET [redacted]

- Moscow is currently in the process of prepaying a major share of its outstanding medium-term Eurocurrency syndications. Known prepayments total $350 million. It is unlikely that Moscow will attempt to refinance the entire amount of prepayments.

[redacted]

Despite an improved balance of payments the USSR has continued to place a reduced level of equipment orders in the West. In our opinion the USSR could easily afford to boost equipment imports, particularly if orders were placed with firms in Western Europe or Japan where government-supported long-term credit remains readily available. Possible factors influencing the downturn in orders include: [redacted]

- a decision to slow the pace of new orders until plant and equipment already delivered or on order has been installed, [redacted]
- a decision to slow orders in view of less than satisfactory performance of equipment already installed, [redacted]
- an awareness of the potential problem of servicing a growing debt in the 1980s when export earnings from oil are questionable, and/or [redacted]
- a tightening of the pursestrings by the State in order to better regulate the outflow of foreign exchange. [redacted]

CIA/OER
11 Oct 1978

SECRET

US-Soviet Trade[1]

	Soviet Exports	Soviet Imports
		Million US $
1973	186	1,381
1974	234	746
1975	191	2,032
1976	264	2,669
1977	369	1,716
1978[2]	145	1,491

1. Official USSR trade data.
2. January-June data.

SECRET

CIA/OER
11 Oct 1978

USSR: Grain Production and Imports 1973 - 1978

Million Tons

	1973	1974	1975	1976	1977	1978 Preliminary Estimate
Grain Production[a] (July-June)	222.5	195.7	140.1	223.5	195.5	+224.0
Grain Imports[b] (Calendar Year)						
TOTAL of which:	24.4	7.7	16.4	21.2	10.8[c]	21.0
United States	15.4	4.1	7.1	12.0	9.8	14.0
Non-Feed (wheat & wheat flour) of which:	15.6	3.1	9.6	7.2	6.3	7.0
United States	9.8	1.3	3.8	2.1	2.8	4.0
Feed (corn, oats, barley, and miscellaneous) of which:	8.8	4.6	6.8	14.9	4.5	14.0
United States	5.6	2.8	3.3	9.9	3.5	10.0

a. Official Soviet reporting.
b. SOURCE: Soviet Foreign Trade Handbook.
c. Estimate -- using both Western and Soviet trade data.

CIA/OER
11 Oct 1978

* * * * *

USSR: DRIVE FOR COMPENSATION AGREEMENTS WITH WEST *

In an effort to ensure long-term hard currency earnings, the USSR is placing increased emphasis on compensation agreements with Western firms. Export earnings guaranteed under the more than 40 agreements signed to date far exceed in value the $8 billion worth of agreement-related imports from the West; annual earnings will rise to nearly $4 billion in 1985 and will soften the impact on Soviet foreign trade of the expected fall-off in oil exports. Despite the intense Soviet interest in compensation agreements, a multitude of problems have slowed the pace of new signings—notably the ineptness of the Soviet bureaucracy and the inadequacy of Soviet support facilities in handling compensation agreements and the difficulties of absorbing large flows of basic Soviet industrial products in already overcrowded world markets.

Background

Compensation agreements—which provide for (a) Soviet imports of Western capital goods on credit and (b) Soviet exports to the West of a portion of the

* This article summarizes a forthcoming Intelligence Assessment by the Office of Economic Research, *USSR: The Role of Compensation Agreements in Trade with the West.*

ER EIW R 78-040

production from the imported equipment to repay the credits—offer several advantages to the USSR. First, they are an economical way to obtain modern industrial equipment from the West. Since compensation exports will normally at least match debt service requirements, the real cost of the equipment to the USSR is essentially the alternative output sacrificed by assigning domestic resources to building the project and—later—producing the portion of the output used as payback.

USSR: Compensation Agreements Signed as of September 1978

		Million US $			
			Scheduled Hard Currency Compensation Exports		
Projects	Number of Agreements	Imports	1977	1980	1985
Total	43	7,604	826	1,994	3,933
Natural gas	8	2,830	566	1,192	2,948
Chemicals	29	3,244	13	281	326
Wood products	4	627	239	403	10
Coal	1	450	0	55	576
Other	1	453	8	63	73

Compensation agreements also reduce the risk associated with buying Western equipment on credit. The heavy reliance of the Soviet economy on planning makes reduction of risk important to top Soviet managers, who have found foreign trade with the West particularly difficult to plan. In 1975, for example, the Western recession practically halted the growth of Soviet hard currency exports, driving home to Moscow the dependence of Soviet exports on Western economic conditions. Compensation agreements protect Soviet industrial ministries and foreign trade organizations from developments in the West that would otherwise reduce Soviet export earnings and hard currency reserves.

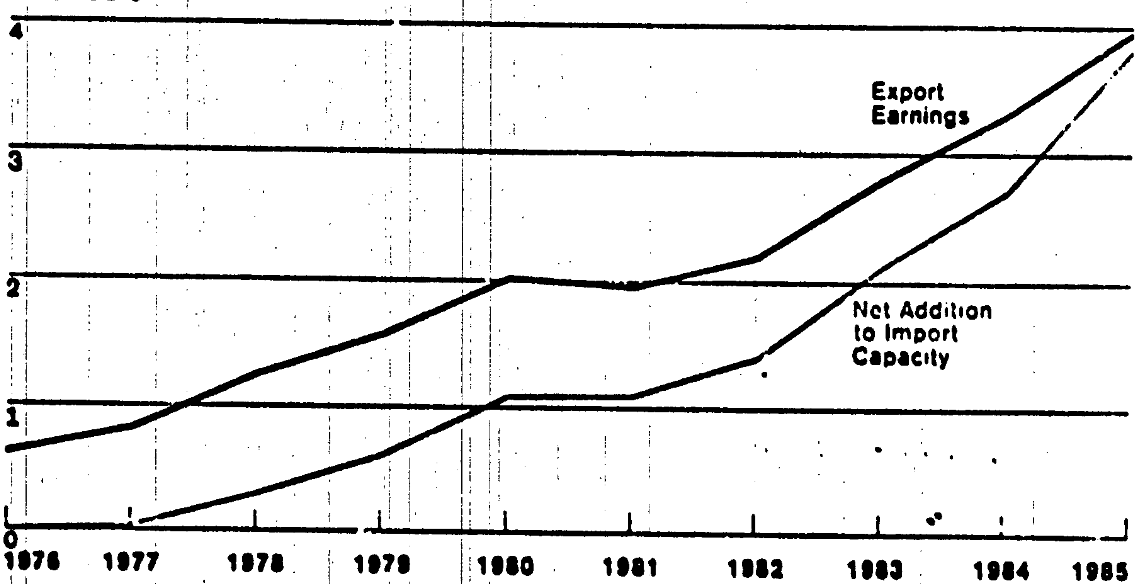
Over the past decade more than 40 compensation agreements have been signed. Nearly $8 billion in Western equipment will be installed in the USSR under these agreements; in turn, Soviet goods of a much larger value will be exported. The most profitable agreements for the USSR are the gas-for-pipe deals with Western Europe which call for Soviet imports of large-diameter pipe for gas lines and subsequent Soviet delivery of gas to Western Europe for periods of up to 20 years and longer. These agreements will generate revenues several times greater than the $2.8 billion worth of Soviet pipe imports.

The Soviet chemical industry, which also has aggressively sought foreign help, has ordered more than $5 billion in equipment and technology for fertilizer, petrochemical, and other plants under product-payback deals. In the only major compensation agreement with the United States, Occidental Petroleum this year began to receive ammonia in connection with a deal for four chemical plants at Kuybyshev. The chemical deals generally involve just enough exports to cover Soviet payments. The other sectors involved in compensation arrangements are timber and wood products, coal, and aluminum.

Compensation Agreements and Total Soviet Exports

Earnings from compensation deals signed thus far are expected to rise from about $830 million in 1977 to nearly $4 billion in 1985. An analysis of compensation agreements shows that revenues from the deals will far exceed costs, yielding Moscow substantial increases in import capacity in the 1980s.

USSR: Estimated Hard Currency Flows From Signed Compensation Agreements



1. Downpayments and debt service on imports under existing compensation deals.

ER ELWR 78-040

The impact of the expected decline in Soviet oil production on foreign trade in the 1980s heightens the importance of compensation agreements. But because of internal Soviet problems and Western disenchantment, few major agreements have been signed since 1974, when deals worth $2.4 billion were concluded. On the Soviet side, debate continues over the policy of committing Soviet raw materials as the price for Western help in developing Soviet resources. The Soviet bureaucracy, moreover, remains ill-equipped to handle compensation agreements, while Soviet ideological attitudes clearly conflict with Western demands for equity participation and/or management control. Even if agreements can be reached in principle, the primitive level of Siberian infrastructure and the difficulties involved in taking on simultaneously several large development projects will slow the proliferation of compensation agreements.

On the Western side, companies are reluctant to accept many Soviet products. Unlike in 1974, when fuel and raw material shortages made long-term supplies of Soviet products attractive to Western firms, they now regard compensation agreements as a disagreeable condition for winning Soviet contracts. The depressed West European chemical industry is already worried about the chemical fertilizers and petrochemicals that the USSR soon will begin to export under compensation agreements.* Deals involving energy suffer much less from this constraint.

Outlook

Despite these problems the USSR is pushing ahead in several large deals with Western firms. If negotiations can be concluded soon, the associated projects would boost Soviet raw material production and exports appreciably by 1985. Deals likely in the near term involve chemicals, wood and wood products, aluminum, and possibly natural gas. Over the longer term, additional compensation agreements could be tied to Siberian natural gas deposits in Yakutsk and Urengoy, a major steel complex, copper deposits, and exploitation of offshore oil reserves.

Moscow has touted compensation agreements as a new form of collaboration with the West. So far, the projects are being carried out on a turnkey basis, in which the participation of the Western firm is essentially completed once the equipment is installed and production is under way. The Soviets have expressed interest in

* See "USSR: Impact of Western Chemical Equipment on Production and Foreign Trade," Economic Intelligence

ER EIWR-78-040

compensation deals involving manufactured goods, but have failed to conclude such agreements—largely because they thus far have refused Western demands for continuing participation to ensure quality.

The expected downturn in oil production and other economic problems may make the USSR more accommodating to Western commercial demands as it tries to boost domestic energy production and develop alternative hard currency exports. The enthusiasm of Western firms will depend on the pace of economic growth and overall East-West relations.

ER EIWR 78-010
5 Oct 78

Prospects for Grain Imports

Unless the USSR grain harvest is considerably larger than 225 million tons, we expect Moscow to purchase between 15 and 20 million tons of foreign grain for delivery during the current (October 1978 through September 1979) marketing year. This estimate is [illegible] mainly on anticipated needs of the livestock sector. Of this total amount, roughly [illegible] million tons will likely be purchased on behalf of non-East European client states. More than half of the imports will probably consist of coarse grains, primarily corn. Imports of 15 to 20 million tons of grain would cost between $2.0 and $2.6 billion, an amount Moscow can easily afford as it is currently in a strong short-term balance of payments position.

Moscow has delayed making its grain purchases this year. To date, confirmed purchases from all sources for delivery to the USSR during the current marketing year stand at only 1.5 million tons. Even if a large portion of the roughly 3 million tons of US corn now recorded in the US Department of Agriculture's "unknown destination" category is (as rumored) intended for the USSR, this would still leave the Soviets 11 to 16 million tons short of estimated needs.* This delay in placing orders differs from past practice; in recent years, when the USSR has purchased 15 million tons or more of grain at least 90 percent of the orders have been placed by 1 October. Possible reasons for the delay this year:

- The likelihood of a worldwide bumper crop allows the USSR to delay purchases with minimal risk of being frozen out of the market. It appears that this year the Soviet Union could obtain perhaps 10 to 11 million tons of grain from non-US suppliers without disrupting long-term trading patterns between these suppliers and their non-Soviet customers.

- Corn prices, on the decline since June, have only recently bottomed out. Moscow may have been waiting to see how far prices were going to drop before placing the bulk of its orders.

---

*At this time last year the USSR had made substantial grain purchases which were not reflected in either of these categories but which were known to us from market sources. This year, in marked contrast, there has been no reporting from market sources of such additional purchases.

-- By withholding orders, the USSR may hope to improve its bargaining position with the US at the LTA meeting scheduled to begin on 11 October. Under the agreement, during the five years beginning 1 October 1976 the Soviets must annually buy at least 6 million tons of wheat and corn and may annually buy up to 8 million tons without prior consultation. At present, only 877,500 tons of US grain -- 200,000 tons of wheat and 677,500 tons of corn -- have been registered with the US Department of Agriculture for delivery to the USSR beginning October 1978.

Considering the availability of non-US grain, Moscow conceivably could keep its total purchases from the US under 8 million tons and still import over 15 million tons during the marketing year. The Soviets are, we think, unlikely to pursue such a purchasing program. Much of the USSR's grain import demand is for corn and other coarse grains to feed livestock. Even though supplies of other coarse grains (mostly barley) are readily available and far less expensive, we believe that Moscow would like to import about 10 million tons of corn, of which 7.5 to 8.0 million tons would have to come from the US. Consequently, we agree with market sources that, offered the opportunity, the Soviets would take more than 8 million tons of US wheat and corn.

The actual level of Soviet imports from the US, and thus the mix among wheat, corn, and other coarse grains of Soviet grain imports worldwide, will likely depend upon the outcome of the LTA meetings. The availability of non-US grain could permit the Soviets to take a hard line at these meetings, if for political reasons they should wish to do so, and in that event their total purchases from the US would be lower than we predict.

GC 78-10188
6 October 1978

26 September 1978

USSR: Economic Problems and Prospects

I. Throughout most of the postwar period, the Soviet economy grew at rates comparable to those of Western Europe, and considerably faster than the United States.

A. Until recently, the USSR was able to realize its growth objectives -- in consumption, investment, and military hardware -- by mobilizing ever increasing amounts of labor and capital.

B. The necessary resources were allocated via the massive state planning and administrative apparatus, which sets prices, production goals, income distribution, investment, and other economic activities that are determined by market forces in Western style economies.

II. Now, however, the Soviet economy faces serious strains which will slow its rate of progress appreciably.

A. Increasing dependence on less accessible and lower quality raw materials is driving-up the cost of investment projects and slowing the growth of new plant and equipment.

1. Exploitation of raw materials to feed the USSR's industrial plant must come increasingly from the climatically harsh Siberian regions, where the cost of operations is nearly double that in the Western USSR.
2. This, in turn, means that major investment projects are becoming longer-term and more costly, requiring large amounts of supporting infrastructure (e.g., roads, housing, etc.) before they can be turned into productive plant and equipment.

B. The agricultural sector continues to be plagued by inefficient management and the vagaries of weather. As a result, Soviet farm production still cannot provide the quality diet that the leadership has promised.

1. Although the regime has invested heavily in the agricultural sector, major disruptions to production occur regularly which impact directly on the lot of the consumer.
2. After the disastrous 1976 harvest, for example, meat supplies fell sharply, resulting in widespread shortages which are still being felt in some quarters.

C. Manpower is another intractable issue confronting the Kremlin.

1. A slowdown in labor force growth began this year and will continue through the next decade. This is an inevitable consequence of falling birthrates in the 1960s.

2. There is little that the Soviets can do to alleviate this constraint. Stop-gap measures such as keeping older workers on the job longer or reducing the term of military service would have only a slight impact on economic growth.

D. Perhaps the most serious economic problem facing the Soviet leadership is a tightening energy supply, especially in oil.

1. For the past half century, the availability of vast energy resources has fueled the USSR's extensive growth model, and Soviet leaders have maximized the short-term exploitation of these resources at the expense of lifetime recovery.

a. In terms of oil, this emphasis on development over exploration has resulted in overproduction of existing wells and fields and failure to match well depletions with new discoveries.

2. Although the USSR has abundant potential oil reserves in the Arctic, East Siberian, and offshore areas, development of such reserves is at least a decade away. Thus, during the next 8-10 years, almost all Soviet oil output will have to come from existing fields and from new fields in existing producing regions.

a. Production from fields in the Western part of the country is already declining, however.

b.. All growth in output through 1980, therefore, must come from West Siberia, where the inhospitable climate, difficult terrain, and vast distances greatly complicate operations.

E ~~VII.~~ The USSR has large reserves of coal and natural gas. Development of these reserves, however, will take time and require large capital investments.

1 ~~X.~~ The cost and physical difficulty of developing the major untapped Soviet gas reserves -- located in norther Tyumen' Oblast -- is unprecedented in the history of the world's oil and gas industries and poses problems not previously encountered either in the USSR or in the West.

2 ~~B~~. Deposits of coal scheduled for exploration in the next decade are also east of the Urals and will require considerable investment in transport and other facilities at a time when investment growth, too, is slowing.

3. ~~C~~. Electric power from hydroelectric and nuclear power plants will make only a small contribution for many years to come. Although there are vast hydroelectric resources in Eastern regions of the USSR, the technical problems of long-distance transmission must be solved before such resources can be fully exploited.

F. ~~VIII~~. Thus, in terms of exploitable energy resources in the 1980s, the USSR appears to be in a difficult situation at best. When oil production stops growing, and perhaps even before, repercussions will be felt on the domestic economy of the USSR and on its international economic relations.

1. ~~A~~. A severe energy shortage could restrict economic growth sharply, further complicating the task of allocating resources to meet the growing needs of consumption, investment, and the military.

2. ~~B~~. Shortfalls in oil production at home could reduce the amount available for export.

1. Since about 1/2 of the USSR's hard currency earnings are due to oil exports, this would cut deeply into the USSR's hard currency earnings and make it difficult for Moscow to maintain its hard currency import capacity.

2. Eastern Europe is critically dependent on the USSR for most of its oil needs. However, Moscow would be under strong pressure to force Eastern Europe to share its oil shortage. Any substantial cuts in oil deliveries to Eastern Europe could worsen its already difficult economic situation and could threaten political stability there.